

**A** *udit*

**R** *eport*



MANAGEMENT OF CONTRACTS FOR  
F110 ENGINE PROCUREMENTS

Report No. D-2001-094

April 4, 2001

Office of the Inspector General  
Department of Defense

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### **Acronyms**

ACO	Administrative Contracting Office
CY	Calendar Year
DCMC	Defense Contract Management Command
DCM GE	Defense Contract Management General Electric
GEAE	General Electric Aircraft Engines
IPE	Improvement Performance Engines
PCO	Procurement Contracting Office



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

April 4, 2001

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
DIRECTOR, DEFENSE CONTRACT MANAGEMENT  
AGENCY

SUBJECT: Audit Report on Management of Contracts for F110 Engine Procurements  
(Report No. D-2001-094)

We are providing this report for review and comment. We conducted the audit in response to allegations to the Defense Hotline. We considered management comments on a draft of this report when preparing the final report.

Although no recommendations were included in the draft report, we are making a recommendation in the final report. DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Director, Defense Contract Management Agency comment on the Recommendation by June 4, 2001.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Bruce A. Burton at (703) 604-9282 (DSN 664-9282) (bburton@dodig.osd.mil) or Mr. Terry L. McKinney at (703) 604-9288 (DSN 664-9288) (tmckinney@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink, reading "David K. Steensma".

David K. Steensma  
Acting Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. D-2001-094

April 4, 2001

(Project No. D2000CF-0276)

### Management of Contracts for F110 Engine Procurements

#### Executive Summary

**Introduction.** This audit was performed in response to an allegation to the Defense Hotline that the Wright-Patterson Air Force Base Procurement Contracting Office made poor procurement decisions on F110 aircraft engine contracts. The allegation also stated that as a result of the Procurement Contracting Office failure to monitor the contract clauses, Government funds were not collected in a timely manner. The contracts relating to the allegation valued at \$7.5 billion, were awarded during calendar years 1984 through 1998. The total amount of money that was identified as not collected in a timely manner was approximately \$50 million. The Administrative Contracting Office, Defense Contract Management Agency at the General Electric Aircraft Engine plant in Cincinnati, Ohio, was responsible for contract administration functions after contract award.

**Objectives.** Our overall objective was to determine whether the allegation to the Defense Hotline had merit. Specifically, we determined whether procurement officials properly managed the contracts for F110 engine procurements and whether overpayments due to the Government were recouped. See Appendix A for a discussion of the audit process and the review of the management control program.

**Results.** We partially substantiated three of the five issues in the allegation to the Defense Hotline. The procurement and administrative contracting office personnel did not adequately manage and monitor certain clauses in contracts for F110 aircraft engines. As a result, the contracting officials were unaware of events that impacted contract performance, and funds owed to the Government were not collected in a timely manner. DoD lost the use of more than \$50 million for other priorities and also lost the opportunity costs associated with this money, which we calculated at approximately \$5.5 million. For details of the audit results, see the Finding section of this report. Also, see Appendix B for a summary of each issue in the allegation and our audit results.

**Summary of Recommendations.** We did not make any recommendations in the draft report because the Procurement and Administrative Contracting Offices initiated definitive corrective actions that should preclude the problems from recurring. However, we are making a recommendation in the final report to request a voluntary payment of lost interest cost from the contractor.

**Management Comments.** The Defense Contract Management Agency further clarified its position on several issues. The Defense Contract Management General Electric has implemented several policies and procedures since the issuance of the draft report to preclude late adjustments when contracts contain a special adjustment clause.

Further, negotiations with General Electric Aircraft Engines were completed in January 2001 and the Government will be reimbursed \$1.05 million from the contractor. See the Finding section of the report for a discussion of the management comments and the Management Comments section of the report for complete text of the comments.

**Audit Response.** We revised information in the report as suggested by the Defense Contract Management Agency. We also commend management on their additional actions to prevent late adjustments on contracts with special adjustment clauses. We request that the Defense Contract Management Agency provide comments on the added recommendation by June 4, 2001.

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## Background

The audit was conducted in response to an allegation to the Defense Hotline that the Procuring Contracting Office (PCO) at Wright-Patterson Air Force Base (WPAFB) had mismanaged Government funds involving F110 engine procurements, which cost the Government millions of dollars. A summary of the five issues included in the allegation are as follows:

- inaction on contract clause H-053 on contract F33657-88-C-2189,
- exclusion of commercial/direct foreign engines from fixed-cost allocation on contracts F33657-94-D-2000 and F33657-98-D-0019,
- tardiness in recouping overpayments on contracts F33657-84-C-2011 and F33657-94-D-2000,
- inaction on contract clause H-001 on contract F33657-94-D-2000, and
- overpricing on a competitive basis and poor procurement decisions on contracts F33657-88-C-2189 and F33657-98-D-0019.

According to the allegation, as a result of inadequate oversight of contract clauses, the Government had not collected adjustments in a timely manner, and in some cases, failed to collect the amounts that were owed. The complaint did not allege that the Administrative Contracting Office (ACO) had committed any errors. The four contracts we reviewed were for the purchase of General Electric F110 aircraft engines valued at \$7.5 billion. The contracts were awarded during the CYs 1984 through 1998.

**Wright-Patterson Air Force Base Propulsion Development System Office.** The Propulsion Development System Office is part of the Aeronautical System Center (ASC) at WPAFB and will be referred to as the Procurement Contracting Office (PCO). The PCO reports to the designated acquisition commander (the commander) in Oklahoma City, Oklahoma. The commander acquires and supports F-15, F-16, and B-2 aircraft engines. The commander is also responsible for the Component Improvement Program, which oversees safety of flight, and the reliability and maintainability of the engines. The PCO at the Propulsion Development System Office purchased engines for the commander. As part of its contract management, the PCO delegated contract administration duties to the Defense Contract Management Office at the GE Aircraft Engine (GEAE) Plant, which produced the F110 series engines.

**Defense Contract Management Agency.** The contract administration office at General Electric in Cincinnati, Ohio, (DCM GE) reports to the Defense Contract Management District East, Boston, Massachusetts, one of two districts immediately subordinate to the Defense Contract Management Agency headquarters at Fort Belvoir, Virginia. DCM GE performs on-site administration of Government contracts awarded to GE aircraft engines and provides services to the cognizant Government PCO and to the contractor. The DCMA office was known as DCMC, prior to March 2000.

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## **Objectives**

The overall objective was to determine whether the allegation to the Defense Hotline had merit. Specifically, we determined whether procurement officials properly managed the contracts for procurement of F110 engines and whether overpayments due the Government were recouped. See Appendix A for a discussion of the audit process and the review of the management control program.



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## Contract Administration

Personnel in the PCO and DCM GE offices did not adequately manage and monitor contracts for General Electric F110 aircraft engines. This situation occurred because these offices lacked coordination, and procedures were not in place to review contract clauses during the period of performance. As a result, contracting officials were unaware of events that impacted contract performance, and funds owed to the Government were not collected in a timely manner. The DoD allowed more than \$50 million to go uncollected for varying periods of time, and lost opportunity costs (interest) were calculated at approximately \$5.5 million.

## Administration Responsibilities

**FAR Criteria.** FAR 1.602-2, "Responsibilities," states:

Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in contractual relationships. In order to perform these responsibilities, contracting officers should be allowed wide latitude to exercise business judgment.

FAR 42.202, "Assignment of Contract Administration," states:

Contracting officers may delegate contract administration or specialized support services, either through interagency agreements or by direct request to the cognizant Contract Administration Office (CAO).

FAR 42.302, "Contract Administration Function," states that one of the contract administration functions was to:

Analyze quarterly limitation on payments statements and recover overpayments from the contractor.

## Monitoring Contract Oversight

**Oversight on Contract Clauses.** Contracting officials did not adequately monitor contract clauses that required close oversight and adjustments or actions during the contract period. Neither the procurement contracting office nor the administration office ensured contract performance for six contract clauses on three contracts within the terms of the contracts.

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**Contract F33657-84-C-2011.** The Government delivered 112 engines to Turkey during CYs 1990 through 1994. Twenty-four engines were delivered in 1990, 24 in 1991, 27 in 1992, 33 in 1993, and 4 in 1994. The engines delivered to Turkey were in accordance with coproduction clause H-053, which states the following.

An adjustment to the contract price may be necessary to recognize special costs incurred, or savings realized: for the Assembly, Inspection and Test (AIT) of engines delivered in Turkey under CLIN 0050; for box, pack, ship, and transportation of engine kits required for coproduction in Turkey; and for the selected F110 engine parts coproduced with Turkey.

The Government was to adjust the contract price for the engines delivered in Turkey based on the H-053 clause. The contract did not specify which office was responsible for monitoring and enforcing the clause and did not specify when to make the adjustments. However, DCM GE was responsible for monitoring the movement of work from one location to another and would have been in the best position to monitor the contract requirement. This failure to monitor the clause went undetected until June 1998 when DCM GE discovered the oversight and notified the PCO of the need to determine whether the adjustments were necessary. The contract did not specify an adjustment method. When the PCO decided to use actual costs as criteria for the adjustment, this lengthened the time for recoupment because of delays in subcontractor audits and final overhead negotiations. As a result, the DCM GE lack of oversight caused a 7-year delay on initiation of action on the contract clause.

In June 1998, GE proposed a refund of \$6,027,000 to the Government for adjustments under the contract clause. The proposal was changed to \$6,871,760 after corrections. In March 2000, GE reimbursed the Government the entire amount of the adjustment.

**Contract F33657-88-C-2189.** In CYs 1993 and 1994, Improvement Performance Engine (IPE) sales were made on two other contracts. One was a Japanese contract and the other was a follow on to contract F33657-88-C-2189. Contract clause H-053 requires that sales on other contracts were to be considered when determining engine prices. Clause H-053 states the following information.

The contractor agrees that if any IPE engines are sold pursuant to a contract other than this contract, then the contractor shall, for the purpose of determining engine prices under this contract, combine those engine quantities with the total quantity of engines acquired under this contract and afford the Government an equitable downward adjustment in contract price.

However, neither the PCO nor DCM GE offices were aware of the need to adjust this contract, and their inaction on this clause was undetected until January 1999, when DCM GE became aware of the need. Although, the contract did not specify the Government agency that was responsible for

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monitoring and enforcing the terms and conditions of the contract, both the PCO and DCM GE agreed that this was part of the DCM GE duties. The PCO accepted some responsibility for not being aware of and asking DCM GE about adjustments to the clause. The clause also did not state when the adjustment should be made. However, it was expected that the adjustment would occur within a reasonable period of time after the other engine sales were completed. In this case, the adjustment was necessary at the beginning of CYs 1994 and 1995, but no action was taken and the problem wasn't discovered for approximately 5 years.

Once the inaction was discovered, DCM GE began the process of collecting an equitable adjustment; however, internal disputes within DCM GE and contract clause interpretation differences with the contractor resulted in 14 additional months passing without resolution, until the DCM GE attempted to issue a final decision. In March 2000, the PCO became actively involved. The PCO requested and obtained a legal opinion that provided an interpretation of the clause. The legal review found merit for including the engines sold to the Japanese and an equitable adjustment was determined. However, the adjustment did not include the engines purchased under the follow on contract. In addition, although the contract clause requires the contractor to combine other engines with engines from this contract to afford the Government an equitable adjustment, the contract did not specify a basis for making an equitable adjustment. Negotiations were completed in January 2001 and the Government will receive \$1.05 million from GE.

**Contract F33657-94-D-2000.** Contracting officials did not closely monitor four different contract clauses on contract F33657-94-D-2000 that required actions during the period of the contract.

**Clause H-001.** An international agreement was established in October 1975 between the United States, and the Governments of Belgium, Denmark, the Netherlands, and Norway relating to the procurement and production of the F-16 aircraft. In accordance with the international agreement, sales to third world countries shall incorporate a premium in the price for coproduction commitments of aircraft. Clause H-001 states the following information.

Each Foreign Military Sales (FMS) F-16 install engine price in the pricing matrices contains \$132,000 to cover the premium for both direct and alternated offset required by H-012, Coproduction. If the international agreement mandating the use of this clause is eliminated or altered during the term of this contract, then the applicable FMS customers will be entitled to a mutually agreeable equitable adjustment in unit price, if such elimination or alteration results in a decrease in the cost of performance of any part of the work.

In 1996, as part of a compliance review to determine whether GEAE was meeting coproduction commitments, DCM GE determined the international agreement was altered significantly on October 26, 1994. The adjustment was not placed into the contract until October 25, 1996, 2 years after the revised agreement was signed. From 1994 through 1996, 98 engines were sold and subjected to potential adjustments in contract price since the altered agreement

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eliminated the \$132,000 premium. The PCO regularly interacted with the F-16 program office and was in the best position to determine that the international agreement changed. However, the PCO was unable to provide an adequate explanation for the 2-year delay in recognizing this clause. The PCO also should have requested a cost impact analysis to determine whether the contractor was required to provide an equitable adjustment for the 98 engines. Any adjustment would have been due back to the foreign Government involved in the purchase of aircraft.

**Clause H-003.** In CYs 1995 and 1996, 129 F110-GEAE-100 and F110-GEAE-129 engines were assembled in Strother, Kansas. Because the engines were assembled in Strother, Kansas, instead of Evendale, Ohio, the Government was entitled to price adjustments. Clause H-003 states the following information.

The Contractor's engine prices are predicated on assembly, inspection, and test (AIT) at the General Electric plant located at Evendale, OH. In the event engine AIT is moved to the Strother, KS plant, the Government shall be entitled to a downward price adjustment per engine for the affected engines, this pertains to the F110-GE-100 and F110-GE-129 Engines.

The contract did not specify whether the PCO or DCM GE was responsible for monitoring and enforcing the clause and did not specify when the adjustment should have been made. DCM GE was responsible for monitoring work, providing onsite surveillance, and would have been in the best position to track this contract requirement.

DCM GE determined the Government was entitled to \$18.7 million in contract clause adjustments. The PCO collected \$10.3 million in FYs 1996 and 1997 for sales from FYs 1995 and 1996 that were to places other than Turkey. The collections for these two periods were made 14 and 16 months later than the sales occurred, which resulted in lost opportunity costs of approximately \$748,000. The adjustment for engine sales to Turkey went undetected until October 1998 when DCM GE noticed the oversight and notified the PCO. In March 2000, the additional \$8.4 million was collected for Foreign Military Sales to Turkey during FYs 1995 and 1996.

The lost opportunity costs for these delayed collections amounted to \$2.3 million. The specific time periods and details of the computations are detailed in Appendix C.

**Clause H-005.** In CYs 1995 through 1998, there were 210 scheduled engine deliveries for DoD, European Participating Group, and Foreign Military Sales customers under this contract clause. Clause H-005 states the following information.

At the end of each calendar year ordering period covered by this contract (except for CY94 engine deliveries), the Administrative Contracting Officer (ACO) shall adjust the order for AFEs and IPEs to reflect the total quantity of engines ordered for delivery in each

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subsequent CY using the Price/Quantity Matrix, Section J, ATCH 2. This adjustment shall be based on the total contractually scheduled deliveries for each CY for Department of Defense (DoD), European Participating Group (EPG) and Foreign Military Sales (FMS) engines ordered under this contract.

The DCM GE was responsible for making the adjustments as specified by the contract clause. The adjustments were made as required, however, they were not collected in a timely manner. A reasonable period of time to make the adjustments should have been no later than 3 months after the end of the year. The adjustments were collected from 1 to 15 months later than required for the four periods involved.

The DCM GE determined the Government was entitled to \$23.4 million for adjustments under the contract clause and the money was recouped; however, since the collections were not timely, DoD lost the use of this money for other operational priorities with an associated lost opportunity cost of \$526,154.

**Clause H-035.** In CYs 1994 through 1998, 97 engines were assembled in Turkey. Since the engines were assembled in Turkey instead of Evendale, Ohio, the Government may have been entitled to a price adjustment for the engines. Clause H-035 states the following information.

The pricing of engines to be provided on the contract is based on pricing identified in Special Provision H-005 'Price/Quantity Matrix' for FMS procurements. Adjustments to the contract price may be necessary to recognize special costs incurred or savings realized (e.g. costs under CLIN 0052 for the Assembly, Inspection, and Testing (AIT) of F110-GE-129 engines produced at TEI for the TUAF as part of the POII engine production effort. This effort includes boxing, packing, shipping and transportation etc., of engine kits required for the TEI co-production effort).

The contract did not specify which contracting office was responsible for monitoring and enforcing the clause. The contract did not specify the time or method for any adjustment. DCM GE was responsible for monitoring work and providing onsite surveillance and could have tracked this contract requirement. DCM GE was aware of the need for possible action on the clause in October 1998.

The DCM GE determined that the Government was entitled to \$1.2 million for adjustments under the contract clause. In March 2000, the PCO collected \$1.1 million in adjustments owed to the Government. As a result of the delayed recovery, DoD lost the use of this money for other operational priorities with an associated lost opportunity cost of \$101,870.

## **Coordination and Control**

Contracts were not adequately managed and monitored because there was no formal coordination between the PCO and the DCM GE on defined duties. In

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addition, these offices did not have procedures in place to ensure that special clauses were reviewed in a timely manner and that appropriate actions were taken when required.

**Formal Coordination.** The contract clauses lacked clarity and did not delineate duties. Only one clause clearly explained that the DCM GE was responsible for the action. Clauses did not specify which office was responsible for adjustments or methods for making them. Formal and regular coordination was essential to ensure that responsibilities on special clauses were clear and that actions were performed. However, there were no written procedures to delineate work or to coordinate activities. In addition, there were no regular scheduled meetings between the PCO and DCM GE to address management and surveillance requirements on these contracts.

**Standard Controls.** The PCO and DCM GE did not have adequate controls in place to ensure that personnel were aware of special clauses that might require action or adjustments during the contract period. There were also no procedures or mechanisms in place to alert the PCO and DCM GE of potential situations that required action on the contract.

## **Timeliness of Collections**

The lack of monitoring and management resulted in more than \$50 million being left unrecovered for periods as long as 9 years. We computed lost interest or opportunity costs of \$5.4 million, for the outstanding amounts. The complete schedule of late recoupments and the time periods involved are detailed in Appendix C.

## **Management's Corrective Action**

We did not make any recommendations in the draft report because the PCO and DCM GE realized the need for better coordination and stronger controls and began implementing corrective actions. The PCO and DCM GE implemented the following corrective actions.

1. Reimplementation of post award conferences between the Propulsion Office, DCM GE, and the contractor after award of new contracts. These conferences will have representatives from contracts, finance, the Program Management Offices, DCM GE, and the contractor. The purpose of the conference is to review all aspects of the contract and ensure all parties are aware of their administrative responsibilities. This will help eliminate any oversight problems of contract provisions which require adjustments.

2. The Aeronautical System Center/Propulsion Development Systems Office will conduct quarterly meetings between the Propulsion Office and DCM GE to discuss issues and upcoming contract actions. During these meetings, discussions will include: status, planning, and schedules on all open adjustments actions/provisions.

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3. A computerized suspense system has been established in the Aeronautical System Center/Propulsion Development Systems Office. Each year, an automatic electronic suspense will be provided to the buying office contracting officers to review all open contracts. A report will be provided to the Propulsion Development Systems Office management on open contract action status and completion schedules.

4. DCM GE conducted training with ACOs and contract administrators on October 25, 2000, to emphasize the need to properly identify special contract clauses. DCM GE will ensure that a review is completed upon initial receipt of the contract.

5. DCM GE has established a standard procedure to identify those contracts containing adjustment provisions in the automated database system as fixed-price redeterminable so that an automatic list of contracts with a special adjustment clause will be generated.

6. DCM GE will conduct post-award conferences with the major engine Supporting Program Office (SPO) to discuss the clauses and the office that will be responsible for monitoring and enforcing the clauses for compliance.

7. DCM GE has established and implemented an annual suspense system to extract a list of contracts from the automated database system to verify that annual adjustments are being made.

8. DCM GE has established quarterly meetings with personnel at Wright Patterson Air Force Base, Ohio, to review actions being taken and compare listings of contracts requiring adjustments. In addition, they also established suspense tracking in their Outlook System and has agreed to share information with DCM GE at the appropriate time.

In addition, a draft Memorandum of Agreement was proposed between the Oklahoma City Air Logistics Center - Propulsion Program Organization at Tinker Air Force Base, Oklahoma; Aeronautical Systems Center - Propulsion Development System Office at Wright Patterson Air Force Base, Ohio; and, DCM GE Aircraft Engines, Contract Management Office, Cincinnati, Ohio. The agreement establishes the relationship between the Contract Management Office, and the F110 Program Offices at Tinker, and Wright Patterson Air Force Bases in support of the F110 engine programs. The agreement outlines the functions and responsibilities of the Contract Management Office which add, modify, or clarify the standard functions outlined in FAR 42.302(a). The agreement assigns individual and specific task responsibilities to program offices and contract management office personnel. However, each organization is responsible to support the other in providing data and manpower, as required. The organization assigned the responsibility for a task will be accountable for its successful accomplishment, work directly with the contractor on that task, and coordinate its effort with the other organization.

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## Management Comments and Audit Response

**Management Comments.** The Defense Contract Management Agency stated that some minor revisions were needed. In addition, the agency stated that the report should indicate that negotiations by DCM GE were completed in January 2001, and the Government will be reimbursed \$1.05 million from General Electric. Also, the DCM GE has implemented several policies and procedures since the issuance of the draft report to preclude late adjustments when contracts contain a special adjustment clause.

**Audit Response.** We revised the report as suggested by the Defense Contract Management Agency. We also commend management on their additional actions to prevent late adjustments on contracts with special adjustment clauses.

## Recommendation

**Added Recommendation.** As a result of management comments, we added a Recommendation to request a voluntary payment of lost interest from the contractor. We request that the Defense Contract Management Agency provide comments on the added Recommendation by June 4, 2001.

We recommend that the Director, Defense Contract Management Agency request a voluntary payment of lost interest from the contractor.



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# Appendix A. Audit Process

## Scope and Methodology

**Work Performed.** Our audit focused on procurement actions and administrative responsibilities of the PCO at Wright Patterson AFB, Ohio, and DCM GE in Cincinnati, Ohio. We interviewed administrative, contracting, and technical personnel at the audit sites. We reviewed four contracts valued at \$7.5 billion. The procurement actions reviewed were from CYs 1984 through 1998.

**Limitations to Scope.** Because our objectives were limited to allegations related to specific contracts, we did not include a review of the management control program beyond the issues related to our objective.

**DoD-Wide Corporate-Level Government Performance and Results Act (GPRA) Coverage.** In response to the GPRA, the Secretary of Defense annually establishes DoD-wide corporate level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following objectives and goal, subordinate performance goal, and performance measure.

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**
- **FY 2001 Subordinate Performance Goal 2.3:** Streamline the DoD infrastructure by redesigning the Department's support structure and pursuing business practice reforms. **(01-DoD-2.3)**

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Contract Management high-risk area.

**Use of Computer-Processed Data.** We did not rely on computer-processed data to achieve the audit objectives.

**Audit Type, Period, and Standards.** We performed this economy and efficiency audit from October through November 2000 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD.

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**Contacts During the Audit.** We visited and contacted individuals and organizations within the Wright Patterson AFB Propulsion Development System Office and the Defense Contract Management Agency. Further details are available upon request.

## **Prior Coverage**

Air Force Audit Agency, Project No. 99061005, "F110-GE-100 Spare Engine and Upgrade Requirements," January 12, 2000.

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## Appendix B. Summary of Allegation and Audit Results

The summary of the allegation issues to the Defense Hotline and our audit results are discussed in the following paragraphs.

**Issue A.** Procurement officials failed to monitor contract clause H-053 on contract F33657-88-C-2189, and, therefore did not make the required adjustments to the contract as required by the clause. Clause H-053 states, “The contractor agrees that if any IPE engines are sold pursuant to a contract other than this contract, then the contractor, shall, for the purpose of determining engine prices under this contract, combine those engine quantities with the total quantity of engines acquired under this contract and afford the Government an equitable downward adjustment in contract price.” Because of inaction on clause H-053, the Government has not received an equitable adjustment for CYs 1993 and 1994.

**Audit Results.** We partially substantiated Issue A. While the PCO assumed some of the blame, the majority of the fault rested with the DCM GE. The DCM GE failed to properly monitor engine sales, and, did not take timely action to receive an equitable downward adjustment owed to the Government. GEAE had three IPE engines sales directly to Japan during CYs 1993 and 1994. Since there were other IPE engines sold on contracts other than this one, the Government should have received an equitable adjustment in both 1993 and 1994. This problem was first discovered in January 1999 by DCM GE. The DCM GE had computed equitable adjustments of \$1,861,892 for the three engine sales. However, GEAE proposed only \$260,772 in adjustments. Negotiations between the DCM GE and GEAE were ongoing as of December 2000.

**Issue B.** Procurement officials excluded commercial/direct foreign engines from fixed-cost allocation on contracts F33657-94-D-2000 and F33657-98-D-0019. The H-053 contract clause on contract F33657-88-C-2189 was incorporated in contract F33657-94-D-2000 under clause H-005. The H-005 clause did not include a provision for including the commercial and direct foreign engine sales of F110 engines in the contract. As a result, the Government overpaid \$5,851,140 during the period 1995 to 1999. These overpayments occurred because the engine sales to the commercial and direct foreign entities did not pay their fair portion of the fixed expenses loaded into the pricing matrix. Contract clause H-007 on contract F33657-98-D-0019 also excluded commercial and direct foreign engine sales from the contract.

**Audit Results.** We found no merit to Issue B with respect to contract F33657-98-D-0019. This contract was awarded based on competition and as a result, the contractors would propose costs based on a competitive environment and the Government would not negotiate or be privy to all of the elements of their pricing. On contract F33657-94-D-2000, while there may be merit to the allegation that not all fixed costs were allocated to direct foreign and commercial sales, the exclusion of these sales from the allegation of direct

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tooling was part of the negotiation consideration and was a judgmental call by the contracting officer. Overhead allocation did include direct foreign and commercial sales in the base for allocating these costs.

**Issue C.** Over the last 10 years, procurement officials knowingly overpaid the contractor and procrastinated on the recoupment of the overpayments. There are two known instances of this occurring that resulted in lost opportunity costs. In the first instance, the PCO procrastinated in recouping \$16,451,762 from clause H-053 of contract F33657-84-C-2011 and clauses H-003 and H-035 from contract F33657-94-D-2000. In the second instance, the PCO procrastinated in recouping \$30,829,763 on clauses H-003 and H-005 from contract F33657-94-D-2000. The total lost opportunity cost from the procrastination was \$7,785,440.

**Audit Results.** We partially substantiated Issue C. The PCO and DCM GE shared blame on this issue. The government was entitled to price adjustments under clause H-053 from contract F33657-84-C-2011, and clauses H-003, H-005, and H-035 from contract F33657-94-D-2000. However, because of poor oversight of the clauses by the DCM GE and poor communication between the DCM GE and PCO, the adjustments were made later than they should have been. In the first instance, \$16,391,489 was recouped. The adjustments were collected an average of 3 years, 5 months later than they should have been. The cost of money lost in this instance was \$4,196,494. In the second instance, \$33,772,376 was recouped. These adjustments were collected an average of 9-1/2 months later than they should have been. The cost of money lost in this instance was \$1,274,803. The total lost opportunity cost of money as a result of the inaction was \$5,471,297.

**Issue D.** Procurement officials did not monitor contract clause H-001 from contract F33657-94-D-2000, and, therefore failed to make the required offset to each engine price as required by the clause. Clause H-001 states the following information.

Each Foreign Military Sales (FMS) F-16 install engine price in the pricing matrices contains \$132,000 to cover premium for both direct and alternated offset required by H-012 Coproduction. If the international agreement mandating the use of this clause is eliminated or altered during the term of this contract then the applicable FMS customers will be entitled to a mutually agreeable equitable adjustment in unit price, if such elimination or alteration results in a decrease in the cost of performance of any part of the work.

The international agreement was significantly altered on October 26, 1994. The foreign Governments conceivably should have received an equitable adjustment as a result of the alteration of the international agreement.

**Audit Results.** We found some merit to Issue D. The PCO did not advise the DCM GE of the change in the international agreement and allowed a 2-year period to pass before a contract modification was issued to reflect the change in the contract. The \$132,000 per engine paid was for offset requirements over and above those included in the cost and pricing data provided in support of the domestic engines. Since the requirement for over and above was eliminated on

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October 26, 1994, DoD should have reacted more quickly to include the change in the contract and request a cost impact analysis to determine whether the contractor should have provided for an equitable adjustment for the 98 engines sold during 1994 to 1996. The PCO did not incorporate TA-17, the new agreement eliminating the \$132,000 premium until October 25, 1996.

**Issue E.** The PCO bought 24, F110-129 engines in 1994 on contract F33657-88-C-2189 at a unit price of \$4,125,000. In addition to the engine price, the PCO paid a lot price for tooling costs. If the PCO had bought the 24 engines on contract F33657-94-D-2000, the unit price would have been \$3,501,738, which included the cost of tooling. Therefore, the PCO overpaid \$623,262 per unit for the 24 engines. The 1994 contract was negotiated in the first quarter in of CY 1994. The second part of the allegation focused on contract F33657-98-D-0019, where the PCO allowed competitive unit prices to increase by 3 percent a year for the period 2002 through 2004. GEAE established a goal for reducing material costs by 6 percent per year.

**Audit Results.** We found no merit to Issue E with respect to contracts F33657-88-C-2189 and F33657-94-D-2000. The 24 engines were ordered on contract F33657-88-C-2189 in CY 93 for delivery in CY 94. Procurement officials could not delay buying the engines because a delay would have meant that the engines would miss the dock-date at Lockheed Martin, and would cause a 9-month break in production and raise prices for the 1994 contract. Contract F33657-94-D-2000 was not awarded until April 1994. Therefore, the 24 engines were ordered on contract F33657-88-C-2189 in CY 1993 before contract F33657-94-D-2000 was awarded. We also found no merit regarding contract F33657-98-D-0019. The contract was awarded on a competitive basis, so the 3 percent price increase was part of the competitive pricing.

## Appendix C. Summary of Overpayments and Lost Opportunity Costs

Contract F33657-84-C-2011, Clause H-053					
Year	Overpayment Calculation	Actual Time Outstanding <sup>1</sup>	Reasonable Time Allowed For Recovery <sup>2</sup>	Excess Time Outstanding <sup>3</sup>	Opportunity Cost <sup>4</sup>
1990	\$1,170,703	9 years, 3 months	4 years, 5 months	4 years, 10 months	\$381,182
1991	\$618,710	8 years, 3 months	3 years, 9 months	4 years, 6 months	\$185,830
1992	\$1,037,283	7 years, 3 months	3 years, 1 month	4 years, 2 months	\$285,358
1993	\$3,748,701	6 years, 3 months	2 years, 7 months	3 years, 8 months	\$894,653
1994	\$296,363	5 years, 3 months	2 years, 1 month	3 years, 1 month	\$58,375
<b>Total</b>	<b>\$6,871,760</b>				<b>\$1,805,398</b>

Contract F33657-94-D-2000, Clause H-035					
Year	Overpayment Calculation	Actual Time Outstanding <sup>1</sup>	Reasonable Time Allowed For Recovery <sup>2</sup>	Excess Time Outstanding <sup>3</sup>	Opportunity Cost <sup>4</sup>
1994	\$175,735	5 years, 2 months	2 years, 3 months	2 years, 11 months	\$32,581
1995	\$300,418	4 years, 2 months	2 years, 4 months	1 year, 10 months	\$33,947
1996	\$642,576	3 years, 2 months	2 years, 3 months	11 months	\$35,342
<b>Total</b>	<b>\$1,118,729</b>				<b>\$101,870</b>

<sup>1</sup> The period from January 1 of the following year to the cash collection date.

<sup>2</sup> The period from January 1 of the following year to the date the overhead rates for that year were finalized. The date the overhead rates were finalized is when the cash collection should have occurred.

<sup>3</sup> The period from the date the overhead rates for that year were finalized to the cash collection date. This was the length of time for which it was unreasonable for the overpayments to remain uncollected.

<sup>4</sup> Interest on overpayments calculated at 6 percent compounded annually for the excess time outstanding.

**Contract F33657-94-D-2000, Clause H-003 (Turkey)**

Year	Overpayment Calculation	Actual Time Outstanding <sup>5</sup>	Reasonable Time Allowed For Recovery <sup>6</sup>	Excess Time Outstanding <sup>5</sup>	Opportunity Cost <sup>4</sup>
1995	\$3,825,000	4 years, 8 months	None	4 years, 8 months	\$1,197,133
1996	\$4,576,000	3 years, 8 months	None	3 years, 8 months	\$1,092,093
<b>Total</b>	<b>\$8,401,000</b>				<b>\$2,289,226</b>

**Contract F33657-94-D-2000, Clause H-003 (Other Than Turkey)**

Year	Overpayment Calculation	Actual Time Outstanding	Reasonable Time Allowed For Recovery	Excess Time Outstanding	Opportunity Cost
1995	\$1,679,000	1 year, 4 months	None	1 year, 4 months	\$136,335
1996	\$8,673,000	1 year, 2 months	None	1 year, 2 months	\$612,314
<b>Total</b>	<b>\$10,352,000</b>				<b>\$748,649</b>

<sup>4</sup> Interest on overpayments calculated at 6 percent compounded annually for the excess time outstanding.

<sup>5</sup> Period from July 1 of that year to the cash collection date. The overpayments on this clause should have been incorporated into the engine price at the time the engines were sold. For practical purposes, we assumed each engine was sold on July 1, the midpoint of the year, rather than compute the overpayment period separately for each individual engine.

<sup>6</sup> Since the overpayments should have been incorporated into the engine price at the time the engines were sold, there was no reasonable period for the overpayments to be uncollected.

Contract F33657-94-D-2000, Clause H-005					
Year	Overpayment Calculation	Actual Time Outstanding <sup>1</sup>	Reasonable Time Allowed For Recovery <sup>7</sup>	Excess Time Outstanding <sup>8</sup>	Opportunity Cost <sup>4</sup>
1995	\$2,872,514	10 months	3 months	7 months	\$100,538
1996	\$14,073,061	8 months	3 months	5 months	\$351,827
1997	\$584,136	1 year, 6 months	3 months	1 year, 3 months	\$44,336
1998	\$5,890,665	4 month	3 months	1 month	\$29,453
<b>Total</b>	<b>\$23,420,376</b>				<b>\$526,154</b>
<b>Total All Contracts</b>	<b>\$50,163,865</b>				<b>\$5,471,297</b>

<sup>1</sup> The period from January 1 of the following year to the cash collection date.

<sup>4</sup> Interest on the overpayments calculated at 6 percent compounded annually for the excess time outstanding.

<sup>7</sup> The adjustments for this clause should have been made within three months after the end of the year.

<sup>8</sup> The period from three months after the end of the year to the cash collection date.



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## **Appendix D. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Acquisition)  
Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Defense Contract Management Agency  
Director, Defense Logistics Agency

### **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, and  
Intergovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International  
Relations, Committee on Government Reform  
House Subcommittee on Technology and Procurement Policy, Committee on  
Government Reform

# Defense Contract Management Agency Comments



## DEFENSE CONTRACT MANAGEMENT AGENCY

6350 WALKER LANE, SUITE 300  
ALEXANDRIA, VA 22310-3241

IN REPLY  
REFER TO

MAR 15 2001

DCMA-OCB

### MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Audit Report on Management of Contracts for F110 Engine Procurements  
(Project No. D2000CF-0276)

The Defense Contract Management Agency has reviewed subject draft report. There are no matters in the report considered to be exempt from public release.

We understand that no written response to this report is required; however, we are providing additional comments (attachment) that should be considered for the final report.

Thank you for the opportunity to comment on the report prior to final issuance. Ms. Jean Carter (703) 428-0997 and Ms. Vivian Hill (703) 428-1003 remain available to provide additional assistance as may be required.

A handwritten signature in black ink, appearing to read "R. W. Schmitt".

ROBERT W. SCHMITT  
Executive Director  
Contract Management Operations

Attachment:  
Project No. D2000CF-0276

Project No. D2000CF-0276

**Management of Contracts for F110 Engine Procurements**

Statement 1: Executive Summary, "Results" paragraph states, "We substantiated three of the five issues in the allegation to the Defense Hotline."

DCMA Comment: This statement should be revised to read as follows: "We partially substantiated three of the five issues in the allegation to the Defense Hotline." Changing this statement will make it consistent with Page 12, Appendix B, "Summary of Allegation and Audit Results."

Statement 2: Page 5, paragraph 2 of the Draft Audit Report states that, "The DCM GE and contractor were still attempting to negotiate an amount for the equitable adjustment as of December 2000."

DCMA Comment: The report should reflect that negotiations by DCM GE were completed in January 2001 and the Government will receive \$1.05 million back from GE.

Statement 3: Page 8, paragraph 4 of the Draft Audit Report "Management Corrective Actions" states that, "We did not make any recommendations because during the course of our audit the PCO and DCM GE realized the need for better coordination and stronger controls and began implementing corrective actions. The Procuring Contracting Officer issued a memorandum dated November 9, 2000, entitled "Department of Defense/Inspector General Investigation," that outlines the following information."

DCMA Comment: Please include the following DCM GE actions that have been taken to preclude late adjustments when contracts contain a special adjustment clause:

1. DCM GE held training on October 25, 2000 with Administrative Contracting Officers and Contract Administrators to emphasize the need to properly identify these types of clauses. DCM GE will ensure a review is done upon initial receipt of the contract.
2. DCM GE has established a standard procedure to identify those contracts containing adjustment provisions in the automated database system as Fixed-Price Redeterminable so that an automatic list of contracts with a special adjustment clause will be generated.

Revised

Revised

Added  
Page 9

3. DCM GE will conduct postaward conferences with the Major Engine Supporting Program Office (SPO) to discuss the clauses and who will be responsible for monitoring and enforcing the clauses for compliance.

4. DCM GE has established and implemented an annual suspense system to pull a list of contracts from the automated database system and verify that annual adjustments are being made.

5. DCM GE has established quarterly meetings with Wright Patterson Air Force Base (WPAFB) to review actions being taken and compare listings of contracts requiring adjustments. In addition, WPAFB has established suspense tracking in their Outlook system and has agreed to share information with DCM GE at the appropriate time.

## **Audit Team Members**

The Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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